INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	5
Conclusion	11

CITATIONS

Cases:

Biltmore Grande Apt. Bldg. Trust, In re, 146 F. 2d 81 — 6

Country Life Apartments v. *Buckley*, 145 F. 2d 935 — 7

Fidelity Assurance Association v. *Sims*, 318 U. S. 608 — 7

Lorraine Castle Apartments Building Corp., In re, 149 F. 2d 55, certiorari denied, 326 U. S. 728 — 7

Marine Harbor Properties v. *Manufacturers Trust Company*, 317 U. S. 78 — 6

St. Charles Hotel Company, In re, 149 F. 2d 645, certiorari denied, 326 U. S. 738 — 6

V. Loewer's Gambrinus Brewery Company, Inc., In re, 141 F. 2d 747 — 7

Statute:

Bankruptcy Act as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840:

Sec. 130 (1) — 8

Sec. 146 — 2, 6, 7

Sec. 179 — 8

Sec. 216 (8) — 8

779411—48

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 587

ABRAHAM KOSDON, SAM HAUSLINGER AND BENJAMIN LAPINE, PETITIONERS

v.

DIVERSEY HOTEL CORPORATION

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINION BELOW

The opinion of the circuit court of appeals (R. 104–109) has not yet been reported. The district court did not file an opinion in this matter.

JURISDICTION

The judgment of the circuit court of appeals was entered on January 21, 1948 (R. 110). The petition for writ of certiorari was filed on February 12, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether both courts below erred in finding that the debtor's petition for reorganization was filed in good faith.

STATUTE INVOLVED

Section 146 of the Bankruptcy Act, as added by the Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 887 (11 U. S. C. 546):

> Without limiting the generality of the meaning of the term "good faith", a petition shall be ~~deemed~~ not to be filed in good faith if—
>
> (1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or
>
> (2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act; or
>
> (3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

STATEMENT

On May 29, 1947, the debtor, an Illinois corporation, filed in the District Court for the Northern District of Illinois a petition for reorganization under Chapter X of the Bankruptcy Act (R. 2–8). Shortly after the petition was filed, certain holders of bonds of the debtor totaling

$88,000 filed answers thereto, joining in the prayer for relief under Chapter X contained in the debtor's petition (R. 9–11). The petitioners herein, who hold bonds of the debtor totaling $21,000, filed answers praying that the petition for reorganization be dismissed for lack of good faith (R. 12–20, 25–26). The district court entered an order on June 13, 1947, approving the petition as filed in good faith and in compliance with the requirements of Chapter X (R. 34). On appeal, the order of the district court was affirmed (R. 110). The Securities and Exchange Commission became a party to the proceedings in the district court pursuant to Section 208 of Chapter X, and participated as an appellee in the appeal (R. 57).

The petition for reorganization alleged that the total value of all of the debtor's property, real and personal, is $1,512,902.72 (R. 4–5). The debtor has substantial earning power as a going concern, as evidenced by its gross rents as of May 1, 1947, amounting to over $216,000 (R. 23).[1] The debtor's liabilities, exclusive of its capital stock, total $1,424,578.74 (R. 5). The principal liability is upon the outstanding First and General Mortgage Income bonds in the amount of $1,387,500 which matured on June 1, 1947 (R. 5).

[1] The supplemental (unprinted) record in the court below (pp. 3–5), not brought to this Court, shows that the debtor realized net earnings from operations sufficient to pay interest at 4% on its outstanding bonds since 1941.

The inability of the debtor to pay these bonds upon their maturity precipitated the institution of the proceedings for reorganization. Petitioners contend (Pet. 17–18) that the value of the debtor's assets is slightly less than the amount of its debts.

In 1932 the real estate of the debtor was the subject matter of a foreclosure suit. The principal amount of the bonds outstanding at that time was the same as it is now, namely, $1,387,500. The bondholders, through a committee, caused the property to be bid in at the foreclosure sale by a newly created Delaware corporation, Diversey Hotel Corporation. This corporation then issued to bondholders its new bonds, par for par with the old bonds, and secured by a new first mortgage dated June 1, 1932, upon the real estate. The corporation also issued all of its capital stock, 100 shares of $10.00 par value, to the committee, of which George W. Pearson was chairman, in trust for the benefit of bondholders. The members of this committee, who became the directors of the Delaware corporation, were authorized by the trust deed securing the new bonds to distribute the stock pro rata among the bondholders or to sell the stock and distribute the proceeds among the bondholders, and it was further provided that any of the stock held at the maturity of the bonds must be distributed among the bondholders (R. 5–6, 28–29).

On September 29, 1938, the Delaware corpora-

tion caused its real estate and other property to be conveyed to Diversey Hotel Corporation, an Illinois corporation, the debtor herein (R. 6). All of the stock of the debtor, 100 shares of $10.00 par value common, was issued to George W. Pearson for the benefit of the bondholders (R. 85). The debtor subsequently assumed and agreed to pay the outstanding bonds (R. 6, 86).

Within a year prior to the maturity of the bonds, the officers and directors of the debtor endeavored to sell the property. The debtor had its property appraised, advertised it for sale, and solicited bids for its purchase. An obstacle to sale appeared to be uncertainty as to whether a marketable title could be conveyed by George W. Pearson, Trustee (R. 92). The only firm bid received was $1,200,000, less than the appraised value of the properties and less than the full amount of the debts (R. 86, 106). No sale was effected.

ARGUMENT

There is no substance to petitioners' contention that the decision of the court below is in conflict with the decisions cited by petitioners. The debtor being unable to meet its maturing obligations, and being unable under its existing security structure to effectuate a sale of its assets without difficulties which might impair realization of an adequate value, it was clearly necessary to effectuate a reorganization, either under Chapter X or otherwise, in order to salvage the substantial going concern value of its business. No prior pro-

ceeding for reorganization was pending in any court and, unlike the situation in many of the cases relied upon by petitioners, there was no problem under Section 146 (4). The courts below were clearly warranted in concluding under Section 146 (3) that it was not "unreasonable to expect that a plan of reorganization can be effected" either through effecting a modification of the debtor's security structure or through a sale plan in the event that a sufficiently attractive offer to purchase the properties should be forthcoming.[2] Petitioners advance no argument as to why the proceeding under Chapter X would not redound to their advantage as well as to that of all other security holders, but merely advance a series of technical objections based, we believe, upon a misreading of the authorities cited. No question is raised which requires consideration by this Court.

1. *Marine Harbor Properties* v. *Manufacturers Trust Company,* 317 U. S. 78; *In re St. Charles Hotel Company,* 149 F. 2d 645 (C. C. A. 3), certiorari denied, 326 U. S. 738; and *In re Biltmore Grande Apartment Building Trust,* 146 F. 2d 81

[2] Subsequent to the decision below the reorganization court, by order dated January 27, 1946, approved a plan providing for the sale of the stock interest in the debtor held by Pearson in trust for the bondholders, payment in full of the debtor's outstanding bonds with interest for the year 1947, and assumption by the reorganized corporation of all other obligations of the debtor. Petitioners have appealed from that order.

(C. C. A. 7), upon which petitioners rely, each involved a prior proceeding pending in a state court, and held that under the facts of the particular case the burden of showing that the interests of creditors and stockholders would not be best subserved in the prior proceeding had not been sustained and that, consequently, the petition for reorganization would not be approved as filed in good faith under Section 146 (4) of Chapter X.

Likewise, there is no conflict with *Fidelity Assurance Association* v. *Sims,* 318 U. S. 608, in which this Court held that where it appears at the inception of a proceeding that the only course open to the corporation is a piecemeal liquidation of its assets and a distribution of the cash proceeds among its creditors, a Chapter X proceeding is inappropriate. Obviously, liquidation of the debtor's estate in the instant case is not required or inevitable. The debtor's property has substantial income and the preservation of going concern value, as an alternative to a forced sale of assets, is available to the bondholders if they choose to have a plan of reorganization so providing.

However, various types of plans are permissible under Chapter X including a sale type of plan as held by *In re V. Loewer's Gambrinus Brewery Company, Inc.,* 141 F. 2d 747 (C. C. A. 2); *Country Life Apartments* v. *Buckley,* 145 F. 2d 935 (C. C. A. 2); and *In re Lorraine Castle Apartments Building Corporation,* 149 F. 2d 55 (C. C. A. 7), certiorari denied, 326 U. S. 728,

While these cases are also cited by petitioners, their applicability is not apparent. If the bondholders prefer a plan of reorganization calling for a sale of the debtor's properties, these cases simply hold that they may accomplish such a liquidation under the provisions of chapter X. However, there is no requirement that the property be liquidated, and if for any reason the bondholders deem it to be in their best interest not to liquidate, they have the alternative of insisting upon a plan under Chapter X providing for an exchange of their old securities for new securities in a reorganized company.

The petition of the debtor for reorganization alleges certain facts which indicate solvency. The controverting answer asserts that the debtor is insolvent. Whether the debtor is insolvent or merely unable to meet its debts as they mature, there can be no serious question as to the existence of a pressing need for relief. Under Section 130 (1), Chapter X is available to a debtor which is insolvent in either sense. See also Sections 179 and 216 (8), which expressly contemplate plans of reorganization which may exclude stockholders.

2. Petitioners' remaining contentions are based upon the somewhat unusual problems growing out of the early abortive reorganization of the debtor, and the circum[illegible] that its principal liabilities are to bondhold[illegible]ho are also the beneficial owners of its common stock. In that

connection petitioners raise points of state law which were rejected by the court below as without merit and which do not in any event present questions of recurrent importance in the administration of Chapter X. It is urged (Pet. 27–29) that the petition for reorganization was not filed in good faith because the debtor was "conceived in fraud". But there was no allegation of fraud in petitioners' answer or amended answer to the Chapter X petition, and there is no evidence of fraud in the record. The assumed fraud is the conveyance of the property by the Delaware corporation to the Illinois corporation and the issuance of all of the shares of the latter corporation in the name of George W. Pearson (Pet. 28–32).

Petitioners argue (Pet. 28) that the Illinois corporation law is more stringent than the Delaware law as it requires the affirmative vote of the holders of two-thirds of the stock in order to sell or mortgage the property of a corporation, whereas the Delaware law requires only a majority vote. This difference in legal requirement would be significant, if at all, only after the stock had been distributed as, obviously, Pearson as trustee for the bondholders has continuously held 100% of the stock.

The further argument is made that the transfer of all of the stock to George W. Pearson as trustee was beyond the power of the original trustees of the stock (Pet. 29–30). This is a fruitless argument. Pearson is an acknowledged

trustee of all of the debtor's stock for the benefit of the bondholders. There is no evidence that the bondholders have been injured by having as trustee one individual rather than another, or some others. If so, Chapter X provides a proper forum for effecting a remedy if such injury has also been suffered by the estate of the debtor.

3. Petitioners assert (Pet. 32) that if the stock of the debtor corporation were to be distributed ratably to the bondholders, the bonded indebtedness would be extinguished by reason of a merger inasmuch as the same persons would be both bondholders and stockholders. This point was not raised in the district court, nor in the original or reply briefs of petitioners in the circuit court of appeals. It was first raised by one of the judges of the circuit court of appeals upon the occasion of the oral argument before that court. Having raised it, the circuit court of appeals disposed of it in its opinion (R. 108–109).

As the circuit court of appeals points out, "merger is at best determined by intention" (R. 109). There is no evidence in the record as to the intention of the parties with respect to merger except what is contained in the 1932 trust deed and what may be inferred as to their intention with respect to keeping the encumbrance alive in the best interest of the bondholders. The practical consequences of a holding that upon the distribution of all of the stock in a new corporation to its bondholders the bonds would im-

mediately cease to represent a debt and therefore have no value, and that all of the value would reside in the stock because of the extinguishment of the debt, would obviously be most unfortunate, if not disastrous, to the individual bondholders.

CONCLUSION

The decision of the court below is correct, and there is no conflict of decisions. The petition should be denied.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

ROGER S. FOSTER,
Solicitor,
Securities and Exchange Commission.

MARCH 1948.

U. S. GOVERNMENT PRINTING OFFICE: 1948